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STATEMENT OF

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COMPTROLLER GENERAL OF THE UNITED STATES

BEFORE THE

POST OFFICE AND CIVIL SERVICE COMMITTEE

HOUSE OF REPRESENTATIVES

ON

THE DESIGN OF A NEW RETIREMENT PROGRAM FOR

FEDERAL EMPLOYEES COVERED BY SOCIAL SECURITY

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our work as it relates to the design of a new retirement program for federal employees covered by social security. The Social Security Amendments of 1983 required all federal civilian employees hired for the first time after December 31, 1983, to participate in social security. The Congress has set January 1, 1986, as the target date for establishing a new retirement program for these employees.

In considering what form this new program should take, we assert as a premise that it should be no more or less generous than prevailing private sector retirement practices. As I will be discussing later, we have identified the characteristics of a "typical" private sector plan and propose this for your consideration as a reasonable standard on which to base federal retirement benefits.

But having said this, it is important to recognize that retirement benefits are but one part of a total compensation package that also includes pay itself, as well as other benefits such as sick and annual leave and health and life insurance. These other components of the compensation package will also require your separate consideration.

We have obtained considerable information on nonfederal retirement programs from selected surveys and studies. Our primary source of information was a 1982 report by the Department of Labor's Bureau of Labor Statistics (BLS) entitled "Employee Benefits in Medium and Large Firms" and the data bases supporting the report. The report covered a survey universe of 976 pension plans with 17 million participants. Other surveys we used included ones performed by Bankers Trust Company, Hay Associates, Hewitt Associates, the Wyatt Company, and the National Association of State Retirement Plan Administrators. The scope of the surveys ranged from very large firms to companies hiring as few as 50 people. While the surveys were not presented as statistically representative of the entire nonfederal sector, we believe they were sufficiently consistent in their findings that prevailing program features could be identified.

Detailed results of our analysis can be found in two of our reports, Features of Nonfederal Retirement Programs (GAO/OCG-84-2, June 26, 1984) and Benefit Levels of Nonfederal Retirement Programs (GAO/GGD-85-30, Feb. 26, 1985). I would like to offer them for insertion in the record at this time.

The surveys showed that retirement programs available in nonfederal organizations typically consist of three parts--social security, a pension plan, and a capital accumulation plan. Since social security is common to both the new federal program and the nonfederal sector's programs, we concentrated our analysis on the pension and capital accumulation portions of nonfederal programs.

We found that the features of a "typical" private sector pension plan are as follows:

--Vesting, the point in time at which a participant has earned the right to a benefit, occurs at 10 years.

--Employees do not contribute to the pension plan.

--Age 62 is the earliest age at which employees receive pension benefits without reduction.

--Early retirement with reduced benefits is available at age 55 with 10 years of service. Benefit amounts are reduced by 4 percent for each year the retiree is under age 62.

--Pension plan benefits are based on the highest 5-year average salary.

--In recognition of the "tilt" in social security benefits to lower income employees, pension plans are integrated with social security by offsetting the amounts the plan would otherwise pay by some portion of social security benefits.

--The "typical" benefit formula in plans surveyed by BLS is 1.5 percent of high-5 year average salary for each year of service less 1.25 percent times social security benefits for each year of service.

--Retirees' benefit amounts are actuarially reduced when survivor benefit coverage is elected.

--A separate long-term disability insurance program is provided in lieu of disability retirement.

--Periodic post-retirement adjustments average 40 percent of the increase in the Consumer Price Index. In larger plans (10,000 or more employees) adjustments average close to 60 percent.

The significance of the capital accumulation plan portion of the typical three-part private sector retirement program is often overlooked in analyses of private sector retirement practices. Capital accumulation plans include thrift plans, profit sharing plans and stock ownership plans. Some employers sponsor more than one type of plan.

Thrift plans, which are the most common type of capital accumulation plan, encourage employees to save for retirement and other needs by providing for employer matching of some portion of the employees' contributions to the plan. The studies showed that employer-matching percentages were usually fixed rates ranging from 10 percent to over 100 percent of employee contributions with 50 percent matching being the most prevalent.

A recent innovation in the capital accumulation portion of retirement programs has been the use of deferred compensation plans authorized by section 401(k) of the Internal Revenue Code. Under the 401(k) approach, an employee can elect to defer a portion of his/her salary and have the employer deposit the deferred amount into an investment account. The amount of the salary deferral, employer matching contributions, and investment earnings are exempt from personal income taxes until the employee withdraws the funds.

We understand that a tax reform proposal to eliminate 401(k) plans is being considered. However, 401(k) plans are not the only type of tax-deferred compensation plan that could be made available to federal employees. Such a plan could be established under other provisions of the Internal Revenue Code. Furthermore, even if the tax deferral on employee contributions was eliminated, a typical thrift plan would still provide for tax deferrals on employer contributions and investment earnings.

To illustrate the benefit amounts available to employees at retirement from the private sector programs in the BLS survey, we calculated benefits at ages 62 and 55 with 30 years of service using final salaries of $20,000, $30,000, $40,000 and $50,000. We assumed employee contributions of 3 percent of pay to a thrift plan during all working years with a 50-percent matching contribution by the employer and interest earnings of 7.5 percent. We found that at age 62 the average benefits ranged from 69 percent of final salary at the $20,000 level to 62 percent at the $50,000 level. At age 55, the benefits ranged from 35 percent of final salary at the $20,000 level to 40 percent at the $50,000 level, exclusive of the benefits available from social security at age 62. (For further details on these estimates, see the attachment to this statement.) For comparison, the current civil service retirement system would provide a benefit of 53 percent of final salary to 30-year employees at all salary levels at age 55 or age 62.

To enhance benefits for employees who retire before social security benefits are available, many private sector employers offer a benefit leveling option. This option allows an employee to receive higher pension plan benefits until social security benefits become available at which time the pension benefits are reduced accordingly. If the age 55 private sector employee in the illustration elected this option, the benefits at retirement would range from 49 percent of final salary at the $20,000 level to 46 percent at the $50,000 level.

The President's 1986 budget proposed that the current civil service retirement formula be changed to base benefits on a

5-year average salary and reduce benefits by 5 percent for each year the retiring employee is under age 65. If these changes were enacted, civil service benefits for the 30-year employee would be reduced to 41 percent of final salary at age 62 and 24 percent at age 55--far less than what a typical private sector plan would provide.

In designing the new program, particular attention must also be paid to the employees of the District of Columbia who now participate in the civil service retirement system. The Social Security Amendments of 1983, which required all new federal employees to be in social security, did not apply to District employees. In a 1978 report,[1] we concluded that the District should establish a separate retirement system for its employees, and we continue to believe this should be done. The exclusion of District employees from social security coverage is a further reason to take this action. Otherwise, District employees will eventually be the only employee group covered by the current civil service retirement system.

With regard to program cost, it seems to us that the Congress must make a policy decision on whether the new system should approximate the cost of the features in nonfederal programs or the cost of the current civil service retirement system. In making this decision, it should be kept in mind that the level of benefits available, rather than cost to the

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[1] Federal and District of Columbia Employees Need to be in Separate Pay and Benefit Systems (FPCD-77-71, Jan. 12, 1978).

government, is undoubtedly what will be of primary importance to newly hired and prospective federal employees. Also, since the addition of social security coverage will, of necessity, make the new system quite different from the current system, cost comparisons between the two systems may well be inappropriate.

Turning now to the question of funding the new pension plan. We have long held the view that federal retirement systems should be fully funded, that is, each participating organization should pay all costs not covered by employee contributions. Full funding would enhance cost recognition and budgetary discipline as well as promote sounder fiscal and legislative decisionmaking. Unintended subsidies of agency programs which are required by law to be financed by users of their services will be avoided. Furthermore, program management should be improved because managers would be more aware of total personnel costs when considering alternative workforce structures.

In summary, regarding the issues you asked us to address, we believe that:

--The vesting period should be 10 years.

--Employees should not be required to contribute to the pension plan.

--The pension plan should be integrated with social security.

--The cost of the new retirement program should approximate the cost of the features in a "typical" private sector plan.

--The pension plan should be fully funded and the cost borne by employing organizations.

--The District of Columbia should establish a separate retirement program for its employees.

Finally, let me again emphasize that our remarks apply to the design of a new retirement program for federal employees covered by social security. We have not addressed issues related to what, if any, changes should be made in the current civil service system.

This concludes my prepared remarks; I will be pleased to answer any questions you may have.

ATTACHMENT ATTACHMENT

BENEFIT LEVELS (PERCENT OF FINAL SALARY) FROM ILLUSTRATIVE PROGRAM

	Final Salary			
	$20,000	$30,000	$40,000	$50,000
Age 62/30 years' service				
Social security	26.0	18.3	13.8	11.0
Pension plan	25.0	29.1	31.6	33.0
Thrift plan*	18.3	18.3	18.3	18.3
Total	69.3	65.7	63.7	62.3
Age 55/30 years' service				
Pension plan	18.9	21.5	23.1	24.1
Thrift plan*	16.0	16.0	16.0	16.0
Total	34.9	37.0	39.1	40.1
Social security at age 62	27.0	19.4	14.6	11.7
Age 55/30 years' service (Benefit leveling elected)				
Pension plan	32.6	31.3	30.5	30.0
Thrift plan*	16.0	16.0	16.0	16.0
Total	48.6	47.3	46.5	46.0

*Assumes 3% employee contribution, 50% employer match, and earnings of 7.5% per year.